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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 211

NIAGARA HUDSON POWER CORPORATION,
Petitioner,

v.

M. VICTOR LEVENTRITT,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RANDALL J. LEBOEUF, JR.,
CRAIGH LEONARD,
15 Broad Street,
New York, N. Y.,
Counsel for Petitioner.

July 20, 1950.

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Petitioner, Niagara Hudson Power Corporation, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above case on February 1, 1950.

Opinions Below

The findings and opinion of the Securities and Exchange Commission are Exhibit D to the application of the Securities and Exchange Commission for enforcement of its order to be found at R. 48-96. The opinion of the

United States District Court, Northern District of New York, appears at R. 107-112 and 86 F. Supp. 697. The opinion of the Court of Appeals (R. 122-127) is not yet officially reported.

Jurisdiction

The judgment of the Court of Appeals was entered on February 1, 1950. Petitioner made a motion to clarify and amend the opinion and judgment of the court which was granted and, upon reconsideration, the judgment was amended by order filed February 14, 1950 (R. 122). Thereupon, petitioner and the Securities and Exchange Commission moved for a rehearing which was denied by order filed February 23, 1950 (R. 151). By order of this Court entered May 18, 1950, the time in which petitioner might file a petition for a writ of certiorari was extended to July 22, 1950. The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code (62 Stat. 928, 28 U.S.C. 1254).

The Question Presented

Where, in connection with a reorganization and liquidation of a public utility holding company, the Securities and Exchange Commission has found that, under the "fair and equitable" standard of Section 11 of the Public Utility Holding Company Act, no participation should be given to warrants of the holding company to buy its stock at a price greatly in excess of the present value of the stock and greatly in excess of any rational forecast of the future value of such stock, may the Court of Appeals require participation in the reorganization for such warrants solely because the warrants were previously traded in the market at some value?

Statutes Involved

The pertinent provisions of Sections 11(b) and 11(e) of the Public Utility Holding Company Act of 1935 are set forth in Appendix A, *infra*, pages 15 to 17.

Statement

Petitioner, Niagara Hudson Power Corporation (Niagara Hudson), is a registered holding company under the Public Utility Holding Company Act of 1935 (the Act). In 1942, the Securities and Exchange Commission (the Commission) instituted proceedings, under Section 11(b) (2) of the Act, looking to the simplification of the Niagara Hudson System and the dissolution of Niagara Hudson as a public utility holding company. After certain steps had been taken to effect a simplification of the Niagara Hudson System, Niagara Hudson, with the approval of the Commission, in May 1948, filed a plan pursuant to Section 11(e) of the Act (the Consolidation Plan), providing for the consolidation of its three principal subsidiaries into a single electric and gas utility company (the New Operating Company). In December 1948, Niagara Hudson filed a second plan pursuant to Section 11(e) of the Act, which was conditioned upon consummation of the Consolidation Plan and which provided for the ultimate dissolution of Niagara Hudson (the Dissolution Plan).

At the times of filing of the plans, Niagara Hudson had outstanding two classes of preferred stock and 9,580,988½ shares of common stock, $1.00 par value. It also had outstanding Class B stock option warrants (the warrants) entitling the holders thereof to purchase at any time 497,191⅚ shares of common stock, each warrant entitling the holder to purchase 1⅙ shares of common

stock upon payment of $50.00 or, in other words, entitling the holder to a call on the common shares at $42.86 a share. The Dissolution Plan called for the exchange of all the outstanding preferred stock of Niagara Hudson for Class A convertible stock of the New Operating Company to be formed in accordance with the Consolidation Plan, and for the exchange of all the common stock of Niagara Hudson for common stock of such New Operating Company under certain terms and conditions stated in the plan. The Dissolution Plan provided that following the completion of all such exchanges, the payment of Niagara Hudson's outstanding bank loans and certain other necessary corporate action, Niagara Hudson would be dissolved. No provision was made in the Dissolution Plan for the outstanding warrants, and the rights of the warrant holders were to be terminated as of the effective date of the plans.

The proceedings with respect to both plans were consolidated, and after hearings, the filing of briefs and oral argument, the Commission on August 16, 1949 issued its findings and opinion approving, with certain modifications which were thereafter made (R. 97-102), both plans as necessary to effectuate the provisions of Section 11(b) of the Act and as fair and equitable to the persons affected by the plans.

In considering the fairness of the plans the Commission reviewed the earnings and operations of Niagara Hudson for the years 1937 to 1948 and considered the forecasts of future earnings and probable dividends submitted by expert witnesses and company officials. It then considered, separately, the treatment accorded by the plans to the holders of the preferred stocks of the three subsidiary companies which were to be consolidated pursuant to the Consolidation Plan, and the treatment

accorded to the holders of each class of the outstanding securities of Niagara Hudson.

With respect to the treatment to be accorded to the holders of the Class B stock option warrants of Niagara Hudson, the Commission found (R. 82):

> "Under the plans, no provision is made for participation of the Class B stock option warrants of Niagara Hudson and all rights represented by such warrants will terminate upon the dissolution of that company.
>
> The option warrants entitle their holders to purchase at any time 497,191⅜ shares of Niagara Hudson common stock, each warrant entitling the holder to 1⅛ shares upon payment of $50. This is equivalent to an exercise price of $42.86 for one share. Since 1932, the Niagara Hudson or predecessor company common stock has never sold at a price higher than 18¼ and has sold as low as ⅞. During the same period, the option warrants have never sold higher than 5 and have been as low as ⅛. In 1948, the prices for the option warrants ranged from a high of 1 to a low of ⅛, and in 1949, from a high of ¼ to a low of ⅛.
>
> In considering the participation to which option warrant holders may be entitled, the test is basically the same as that applied with respect to the other types of securities, that is, what value, if any, is being given up by the surrender of the rights attaching to that security. The price of $42.86, which a holder of an option warrant would have to pay for one share of Niagara Hudson common stock, is more than 30 times the estimate we have used of $1.39 as foreseeable earnings which would be applicable to that stock on the basis of present investment if Niagara Hudson were to continue. That price is about 3.5 times the recent high market prices for the Niagara Hudson common stock of around 12 per share.

If we were to assume that Niagara Hudson were to continue and its common stock were to sell in the future at a ratio of 15 times consolidated earnings, which would appear to be a very liberal assumption, it would require per share earnings of $2.86 to result in a price of $42.86 per share. Such earnings would represent an increase of 106% over the approximately $1.39 of earnings which we have found attributable to the present investment. On the basis of the more likely assumption that the price-earnings ratio at which the Niagara Hudson common stock would sell would be something less than 15 times, an even greater increase in earnings would be required to attain a per share price of $42.86.

Under all the circumstances, we cannot find that there is a reasonable expectation that the market price of Niagara Hudson's common stock would exceed the exercise price of the option warrants within the foreseeable future. Accordingly, we find that such option warrants have no recognizable value[39] and that the plans satisfy the standard of fairness and equity with respect to such option warrants in excluding them from any participation in the reorganization of Niagara Hudson."

"[39] We recognize that the holders of the option warrants have a right to purchase common stock at any time, and that this perpetual feature has some present value no matter how remote or speculative the exercise of the right might be. The value to be accorded that right, however, in this case, is so small that as a practical matter we would not be justified in recognizing it for the purposes of a Section 11 reorganization. *Cf. Electric Power & Light Corporation*, —— S.E.C. —— (1949), Holding Company Act Release No. 8889."

Application was thereafter made by the Commission to the United States District Court for the Northern District of New York to enforce and carry out the terms and provisions of the plans and, after hearing, an "Order Enforcing Plans" was entered on November 4, 1949.

Respondent appealed to the United States Court of Appeals for the Second Circuit, which reversed that part of the order of the District Court which enforced the provisions of the Dissolution Plan relating to the warrants and remanded the proceedings to the Commission for further action in accordance with the court's opinion, which in effect required that consideration must be given by the Commission to evidence of the past market value of the warrants.

Specification of Errors To Be Urged

The Court of Appeals erred:

(1) In holding that the evidence of past earnings and a forecast of future earnings, upon which the Commission relied in arriving at its valuation of the warrants, was not substantial evidence within the meaning of the Act.

(2) In holding that the evidence of past market value of the warrants requires the Commission to ascribe some value to the warrants in a Section 11 reorganization.

(3) In substituting its evaluation of the weight to be given to the evidence of past market value for that of the Commission, and in substituting its judgment of the inferences to be drawn from the history of past trading in the warrants for that of the Commission.

(4) In failing to affirm *in toto* the order of the District Court enforcing the plans.

Reasons for Granting Writ

This is a case of great importance because the effect of the decision of the court below is to require the Commission, in making valuations in reorganization proceed-

ings, to be guided by market value rather than the intrinsic value which it has a statutory duty to determine. We urge that the writ be granted for the following reasons:

A. The Commission's determination that the warrants have no recognizable value for the purpose of a Section 11 reorganization is based upon competent evidence that the exercise price of such warrants is substantially in excess of the present value of the stock purchasable upon exercise of the warrants, and substantially in excess of any rational forecast as to the future value of such stock in the light of foreseeable earnings. The court below has rejected the Commission's valuation and substituted its own judgment that because the warrants were traded in the open market, some value must be ascribed to them. The court below has thus decided a question of importance relating to the construction of the Public Utility Holding Company Act of 1935 without giving proper effect to the applicable decisions of this Court, *inter alia, Otis & Co.* v. *Securities and Exchange Commission,* 323 U. S. 624, *Securities and Exchange Commission* v. *Central-Illinois Securities Corp.,* 338 U. S. 96.

B. In rejecting the evidence of foreseeable future earnings and relying upon evidence of market value only, the court below has departed from the valuation standards approved by this Court in all reorganization proceedings and has ignored the statutory edict that the findings of the Commission shall be final if supported by substantial evidence. The court below has, therefore, decided a federal question in a way in conflict with the applicable decisions of this Court.

Argument

In arriving at its conclusion that the warrants had no recognizable value and that the Plan met the "fair and equitable" standard provided by the Act, even though no provision is made for participation by the holders of the warrants, the Commission considered, as indicated by its findings and opinion, among others, all of the following factors: (1) The exercise price, $42.86. (2) The market price range of the common stock of Niagara Hudson and its predecessor company since 1932, 18¼ to ⅞. (3) The market price range of the warrants for the same period, 5 to ⅛. (4) The foreseeable earnings applicable to the stock of Niagara Hudson if it were to continue, $1.39 per annum. (5) The earnings that would be required to result in a price of $42.86 per share if Niagara Hudson were to continue, and its common stock to sell at a ratio of fifteen times consolidated earnings, $2.86.

The court below, however, stated in its opinion that it could not agree that there was any evidence, substantial or insubstantial, to support the findings that the warrants were wholly worthless. It is obvious, therefore, that the court below has rejected the validity of both past earnings and a forecast of future earnings as a standard of valuation in reorganization proceedings. This conclusion is in direct conflict with the decision of this Court in *Otis & Co.* v. *Securities and Exchange Commission, supra*, where the Commission's valuation of the relative rights to participate in a public utility holding company reorganization were sustained although premised entirely upon the Commission's estimate of future earnings.

Since it must be conceded that there was *some* evidence to sustain the Commission's valuation finding, it remains only to consider whether the scope of judicial review

would permit the court below to reject the evidence upon which the Commission acted, and substitute its own judgment based upon the evidence of past market value. We submit that the decision of the court below quite evidently violates the substantial evidence rule and exceeds the proper scope of judicial review.

The Court has recently defined the degree of finality which must be accredited to administrative findings as to valuation in *Securities and Exchange Commission* v. *Central-Illinois Securities Corp., supra.* There Mr. Justice Rutledge said (p. 126):

> "Administrative finality is not, of course, applicable only to agency findings of 'fact' in the narrow, literal sense. The Commission's findings as to valuation, which are based upon judgment and prediction, as well as upon 'facts,' like the valuation findings of the Interstate Commerce Commission in reorganizations under §77 of the Bankruptcy Act, * * * are not subject to reexamination by the court unless they are not supported by substantial evidence or were not arrived at 'in accordance with legal standards.'"

The Commission's findings here were based upon the facts of past earnings and past market values of the Niagara Hudson stock. They were based also upon the Commission's prediction as to future earnings and future market values for such stock. The ultimate conclusion that the warrants were without recognizable value represented the Commission's judgment based upon such facts and prediction. The Commission's valuation is, therefore, not subject to reexamination by a court.

The decision of the court below would seem to indicate that evidence is to be regarded as "substantial" only if there is no conflicting evidence. This proposition is clearly

untenable and at variance with numerous expressions by this Court to the effect that questions as to the weight to be given to evidence or as to inferences to be drawn therefrom are to be resolved by the administrative agency and not by the reviewing court. *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164; *Opp Cotton Mills* v. *Administrator*, 312 U. S. 126; *National Labor Relations Board* v. *Link-Belt Company*, 311 U. S. 584; *South Chicago Company* v. *Bassett*, 309 U. S. 251.

Even if market value were an acceptable criterion of valuation, therefore, the Commission, under the substantial evidence rule, would not be required to rely upon it, if in the Commission's opinion the other evidentiary factors outweighed the evidence of market value in determining intrinsic value. Intrinsic value rather than market value, moreover, has been uniformly adopted by this and lower courts as a valuation standard in reorganization proceedings. See *Group of Institutional Investors* v. *Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523; *In re American & Foreign Power Co.*, 80 F. Supp. 514; *In re Central States Power & Light Corporation*, 74 F. Supp. 360; *In re United Gas Corporation*, 58 F. Supp. 501, aff'd 162 F. 2d 409.

Furthermore, it is clear that if the Commission were required to be guided by market value, as the court below suggests, then the whole statutory purpose of leaving to the Commission the determination of what valuations are fair and equitable to the security holders involved in a reorganization would be defeated. Valuations would thus become a mere reflection of the aleatory and speculative judgments of traders in the market place rather than, as Congress intended, the considered deliberations of an expert administrative agency.

Finally, it should be noted that even though the warrants are described by the respondent as "perpetual",

actually the right of exercise exists only so long as Niagara Hudson Power Corporation as a corporate entity continues in existence. Since the Commission's order contemplates the dissolution of Niagara Hudson within approximately one year from the effective date of the plans, in early 1951, it is apparent that the discrepancy between the existing market value of Niagara Hudson stock and the exercise price of the warrants is too great to justify any value at all being ascribed to the warrants.

The court below has erred in rejecting the evidence of past earnings and a forecast of future earnings as a standard of valuation. It has erred in relying solely upon market value as such a standard. It has erred in usurping the function of the administrative agency by substituting its judgment for that of the agency where there is substantial evidence of absence of intrinsic value to support the agency's findings. It is thus of great importance that this Court should consider the issues raised in this proceeding, so that the Commission may continue to exercise its proper statutory powers in reorganization proceedings under the Public Utility Holding Company Act of 1935.

The decision below was rendered by a divided court, Judge Clark concurring in result only to the extent that the decision might be construed as remanding the cause back to the Commission to give further consideration to the market history. Upon application for rehearing (which showed that the Commission had considered and rejected that history) this same Judge dissented from the court's decision denying rehearing.

It is submitted that under the circumstances here present a remand to the Commission will be completely futile. The Commission has already considered all the evidence that is available as to the value of the warrants. In accordance with the decisions of this Court it has based

its conclusion upon evidence of past earnings and a forecast of future earnings. On the other hand, in the exercise of its expert administrative discretion and in reliance upon decisions of this and other courts it rejected the evidence of market value as determinative of intrinsic value in this reorganization proceeding.

Since the Commission has already considered all the available evidence, it could hardly arrive at a different conclusion upon remand. If it were to follow the directions in the opinion below and arrive at a different conclusion by reason of the past market value of the warrants, the consequence is to rob the Commission of its statutory duty to make expert valuations and to substitute therefor the judgment of the Court—a clear usurpation of the statutory functions of the Commission.

CONCLUSION

For the reasons stated it is respectfully requested that the Writ of Certiorari be issued.

RANDALL J. LEBOEUF, JR.,
CRAIGH LEONARD,
Counsel for Petitioner.

July 20, 1950.

APPENDIX A

Excerpts from Section 11 of the Public Utility Holding Company Act of 1935

"Sec. 11

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

* * * * * * * * * * *

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

Appendix A

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

* * * * * * * * * *

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such

extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed."